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H.R. 698– Industrial Bank Holding Company Act of 2007

Floor Situation

H.R. 698 is being considered on the floor under suspension of the rules and will require a two-thirds majority vote for passage. This legislation was introduced by Representative Paul Gillmor (R-OH) on January 29, 2007. The bill was ordered to be reported from the Committee on Financial Services, by voice vote, as amended, on May 16, 2007.

H.R. 698 is expected to be considered by the House of Representatives on May 15, 2007.

Summary

H.R. 698:

- Establishes that companies that own Industrial Loan Companies (ILCs) will be subject to regulation by the FDIC at the holding company level.

- Creates a new type of entity, the industrial bank holding company (IBHC) which the bill defines as a company that controls directly or indirectly any industrial bank and is not already subject to holding company supervision by the Federal Reserve, the OTS, or the SEC.

- Gives the FDIC certain supervisory powers to regulate the IBHCs including:

    - Registration: An IBHC must register with the FDIC within 90 days of either the date of the enactment of this bill or of becoming an IBHC.

    - Examination: An IBHC and its subsidiaries will be subject to examination by the FDIC.

    - Enforcement: The FDIC will have the authority to apply a similar enforcement regime to IBHCs that the Federal Reserve applies to bank holding companies.

- Capital: The FDIC will have the authority to set capital adequacy standards for IBHCs. The FDIC will also have the authority to prohibit an IBHC from making capital distributions if the underlying ILC is significantly undercapitalized.

  **Note: The FDIC's authority to prohibit capital distributions from significantly undercapitalized ILCs is similar to the Federal Reserve's authority over bank holding companies.*

- Acquisition of ILCs: The FDIC will regulate the acquisition of ILCs.

  **Note: this is similar to how the Federal Reserve regulates the acquisition of banks.*

➢ Closing the Foreign Bank Loophole: A foreign bank must obtain a determination from the Federal Reserve (in consultation with the FDIC) that the foreign bank is subject to consolidated comprehensive supervision (CCS) in its home country before it can acquire an ILC. In some circumstance the OTS and fed will make a joint determination.

Separation of Banking and Commerce

➢ Commercial firms, except those that are grandfathered, will be prohibited from owning ILCs.

- 85-15 Test: A firm will be "commercial" if it had at least 15 percent of its revenues from non-financial activities in three of the last four calendar quarters.

➢ Firms with existing ILCs will be grandfathered in one of two categories.

Pre-2003

- A commercial firm can own an ILC if the ILC was established before October 1, 2003 or if the application for FDIC deposit insurance was approved before that date.

- The commercial firm loses this grandfather if the ILC undergoes a change in control after September 30, 2003.

- There are no activities or branching restrictions with this grandfathering provision.

Pre-2007

- A commercial firm can own an ILC if the commercial firm acquired the ILC on or after October 1, 2003 and before January 29, 2007.

- The commercial firm loses this grandfathered status if (1) it acquires any other depository institutions after January 28, 2007, or (2) its depository institution subsidiary undergoes a change in control after January 28, 2007.

- The commercial firm also loses this grandfathered status if after January 28, 2007 the ILC engages in new activities or branches into new states.

➢ Divestiture: Provides that a non-grandfathered company that owns an ILC, if it fails the 85-15 test for a commercial firm, must divest the ILC within two years (with a possible a one-year extension).

Background
According to the FDIC, Industrial Loan Companies (ILCs), **"**are state chartered companies with broad banking powers that can operate with federal deposit insurance. Currently, there are 56 FDIC-insured ILCs, mostly headquartered in Utah and California. Five other states—Colorado, Minnesota, Indiana, Hawaii and Nevada—permit these charters. In existence since the early 1900's, ILCs are regulated by the chartering state regulator and by the FDIC. ILCs are not subject to the Bank Holding Company Act (BHCA) and Federal Reserve supervision, permitting a variety of financial and nonfinancial ILCs owners."

ILCs (known as industrial banks in California and Utah and thrift companies in Nevada) can engage in most banking activities under specific state law. Under federal law these institutions cannot now accept demand deposits (i.e., business checking accounts, whether bearing interest or not). They are vestiges of an early-20th-century mode of finance, in which state-chartered loan companies served the borrowing needs of "industrial" workers that banks would not provide. Many later merged with commercial banks; 12 states still have industrial bank-charter options.

The FDIC began to insure the deposits of a few ILCs in 1958. After collapses of state ILC insurance funds in Utah and California, the Garn-St Germain Depository Institutions Act of 1982 encouraged the FDIC to cover deposits of ILCs operating safely. It insured commercially owned ILCs commencing in 1988.

Under their state charters, ILCs are not greatly limited in the types of business they may conduct. ILC activities vary from being community-oriented consumer and small business lenders, to specialty lenders, to auxiliaries of their owners' corporate treasuries, to financiers of their parents' large-dollar products. ILCs and, especially their parent owners, need not always carry as much capital as banks and their holding companies. (CRS: RL32767)

Cost
"The Congressional Budget Office (CBO) estimates that enacting H.R. 698 will have a negligible effect on federal direct spending and revenues. H.R. 698 contains intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA),

but CBO estimates that the cost of complying with the requirements would not exceed the threshold established in UMRA ($66 million in 2007, adjusted annually for inflation).

The bill contains private-sector mandates as defined in UMRA. Those mandates are on industrial bank holding companies, and commercial firms and foreign banks that want to own an industrial bank. Because the future regulatory and business decisions are unknown, CBO cannot estimate the cost of some of the private-sector mandates in the bill, and is uncertain whether the aggregate direct cost of all the mandates would exceed the annual threshold established by UMRA ($131 million in 2007, adjusted annually for inflation)." Congressional Budget Office Cost Estimate

Staff Contact

For questions or further information contact Matt Lakin at (202) 226-2302.